In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 626

FRANK NICK, PETITIONER

v.

JOHN B. DUNLAP, Acting Collector of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The oral opinion of the District Court (R. 40-41) is not reported. The *per curiam* opinion of the Court of Appeals (R. 49) is reported at 185 F. 2d 674.

JURISDICTION

The judgment of the Court of Appeals was entered on December 21, 1950. (R. 50.) The petition for a writ of certiorari was filed on March 21,

1951. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Taxpayer underpaid his 1945 income taxes. The Commissioner determined that the underpayment was due to fraud and assessed a deficiency in tax, together with the fraud penalty provided by Section 293 (b) of the Internal Revenue Code. In a later year, taxpayer incurred a net operating loss which, when carried back and deducted in 1945, resulted in a refund of part of the amount which he had paid as deficiency taxes for 1945.

The question presented is whether the Court of Appeals erred in sustaining the District Court's determination that the carry-back of the net operating loss did not entitle taxpayer to a corresponding refund of the fraud penalty.

STATUTES INVOLVED

These will be found in the Appendix, *infra,* pp. 9-12.

STATEMENT

The material facts as stipulated (R. 13-29) and as found by the District Court in its oral opinion (R. 40-41) are as follows:

Taxpayer timely filed his 1945 income tax return reporting taxable net income of $5,393.15 and a tax thereon of $1,219.01. In fact, however, taxpayer had more taxable income than reported in his return and at a later date he so notified the Commissioner of Internal Revenue. After investigation,

the Commissioner determined that taxpayer had omitted from his 1945 return $31,885.63 of net taxable income and that the omission had been due to fraud with intent to evade tax. Pursuant to this determination, the following additional assessments were made against taxpayer for 1945:

Deficiency in tax	$17,450.56
Addition to tax for fraud (50 per cent of deficiency)	8,725.28
Interest on deficiency	1,511.92

These amounts have been paid and, except as affected by the 1947 loss carry-back, are not in dispute (R. 14, 40.)

For 1947, taxpayer's income tax return disclosed a net operating loss of $26,616.94. Taxpayer filed an appropriate refund claim asking to have the loss carried back and allowed as a deduction in 1945, with a consequent reduction of tax liability for the latter year. The refund claim was in the amount of $23,543.47, and included not only that part of 1945 taxes which would be refundable as a result of allowing the net operating loss as a deduction, but also corresponding portions of the fraud penalty and deficiency interest which had been assessed for 1945. (R. 14, 17-20.)

The Commissioner allowed the claim in part and refunded to taxpayer $13,491.93, with interest. The balance of the refund claim was disallowed, the Commissioner having concluded that no part of the fraud penalty or the deficiency interest was

refundable; and, further, that taxpayer had overstated his 1947 operating loss. (R. 15-16.)

Taxpayer then brought the present action, challenging each of the foregoing adjustments. However, after the trial began, he abandoned his contest of the Commissioner's action in reducing the 1947 net operating loss and also conceded that the recent decision by this Court in *Manning* v. *Seeley Tube & Box Co.*, 338 U.S. 561, foreclosed any right to recover deficiency interest. (R. 37-38.)

The only issue left for determination was whether the taxpayer was entitled to a refund of a portion of the 1945 fraud penalty. The District Court ruled that he was not, and directed that judgment be entered for the Collector accordingly. The Court of Appeals, as we have said, affirmed *per curiam* (R. 49) on the authority of the *Seeley Tube* decision.

ARGUMENT

There is no occasion for further review of this case. Certainly there is not shown, nor can there be found, any conflict among the Courts of Appeals in respect of the problem concerned. Moreover, we maintain that the Fifth Circuit was entirely correct in its conclusion (R. 49) that this Court's decision in *Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561, is controlling here. It is manifestly immaterial that the Bureau of Internal Revenue may have incorrectly treated the matter prior to final

determination in *Manning* v. *Seeley Tube & Box Co.* (Pet. 8-9, Br. 17-18.)

We make no assertion, of course, that the *Seeley Tube* case is directly authoritative. What we submit is that, somewhat comparable to this Court's reliance in *Commissioner* v. *Connelly*, 338 U. S. 258, upon its precursor decision in *Mitchell* v. *Cohen*, 333 U. S. 411, the precise question which was before the two courts below in this instance has been answered in favor of the government by the rationale of *Seeley Tube*. Indeed, in our judgment, the present proposition is implicit in the *Seeley Tube* decision.

It will be recalled that in *Seeley Tube, supra*, the taxpayer filed its returns for the fiscal period ending in 1941 and paid the reported taxes. In 1943 the Commissioner assessed additional taxes for 1941, together with deficiency interest. These assessments were still unpaid when taxpayer filed its 1943 corporate income tax return disclosing a substantial net operating loss which, when carried back pursuant to Section 122 of the Internal Revenue Code (Appendix, *infra*, p. 10), was sufficient to offset all taxable net income for 1941. Accordingly, Seeley filed claims for refund of 1941 taxes already paid and for abatement of the outstanding deficiency assessments for that year. The Commissioner recognized taxpayer's right to the asserted loss carry-back and abated the tax deficiency, but declined to abate the interest which had been assessed on the deficiency. Collection of the defi-

ciency and interest thereon having been effected, taxpayer sued for its recovery. When, in due course,[1] the case reached this Court, it reversed the judgment below, and held that, "The subsequent cancellation of the duty to pay this assessed deficiency does not cancel in like manner the duty to pay the interest on that deficiency." 338 U. S. at 565. In so holding, the Court reasoned that the enactment of the carry-back provisions in 1942 did not alter the basic obligation of taxpayers to pay promptly taxes which were properly due at the close of the tax year; and that, while for certain purposes the carry-back resulted in a *de novo* determination of the tax, it did not operate retrospectively to discharge the statutory increments which had accrued by reason of a taxpayer's failure to pay his full tax on time.

Congress has required the filing of honest tax returns as well as timely ones. The purpose of the 50 per cent fraud penalty is to induce the filing of honest tax returns, just as the purpose of the interest requirement is to induce prompt payment. In this case, the fraud penalty became due when the false return for 1941 was filed. It was only because of the loss in a subsequent year that part of the underlying tax deficiency was refunded. The core of the petitioner's argument is that the fraud pen-

[1] See *Seeley Tube & Box Co.* v. *Manning*, 76 F. Supp. 937 (D. N. J.), upholding the Commissioner; reversed on appeal, 172 F. 2d 77 (C.A. 3d), certiorari granted, 337 U. S. 955.

alty can only be computed upon the basis of the 1945 tax deficiency as thus reduced by the carryback of his 1947 operating loss. But it is clear from the rationale of the *Seeley* decision that a loss in a subsequent year does not wipe out the fraud liability [2] of the earlier year, any more than it cancels the duty to pay interest on the tax deficiency of the earlier year.[3]

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[2] It is of course immaterial that in the instant case there was a voluntary disclosure of the taxpayer's understatement of income for 1945, just as the actual cost, if any, to the Government arising out of the understatement is immaterial. *Helvering* v. *Mitchell*, 303 U.S. 391.

[3] The *Seeley Tube* decision by this Court states in pertinent part (338 U. S. 561, 566, 567-568):

"It is apparent from an inspection of the Code that Congress intended the United States to have the use of the money *lawfully* due when it became due. *Several sections of the Code prescribe penalties and additions to the tax for negligence and fraud.* A taxpayer who files a timely return but does not pay the tax on time must pay interest on the [lawful] tax until payment.

* * * * *

Although it is true that for many purposes the carryback is equivalent to a *de novo* determination of the tax, our conclusion that this section does not retroactively alter the duty of a taxpayer to pay his *full* tax promptly is amply supported by § 3771(e) of the Code. * * *

To sustain respondent's contention would be to place a premium on failure to conform *diligently* with the law. * * *" (Italics supplied.)

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
A. F. PRESCOTT,
MARYHELEN WIGLE,
Special Assistants to the Attorney General.

APRIL, 1951.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(s) [As added by Sec. 211 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 53. TIME AND PLACE FOR FILING RETURNS.

(a) *Time for Filing.*—

(1) *General Rule.*—Returns made on the basis of the calendar year shall be made on or before the 15th day of March following the close of the calendar year. Returns made on the basis of a fiscal year shall be made on or before the 15th day of the third month following the close of the fiscal year.

* * * * *

(26 U.S.C. 1946 ed., Sec. 53.)

SEC. 56. PAYMENT OF TAX.

(a) *Time of Payment.*—The total amount of tax imposed by this chapter shall be paid on the fifteenth day of March following the

close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the third month following the close of the fiscal year.

* * * * *

(26 U.S.C. 1946 ed., Sec. 56.)

SEC. 122. [As added by Sec. 211 (b) of the Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.

(a) [as amended by Sec. 105(e), Revenue Act of 1942, c. 619, 56 Stat. 798] *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [As amended by Sec. 153 (a) of the Revenue Act of 1942, *supra*.] *Amount of Carry-Back and Carry-Over.*—

(1) *Net Operating Loss Carry-Back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations pro-

vided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

* * * * *

(26 U.S.C. 1946 ed., Sec. 122.)

SEC. 292. INTEREST ON DEFICIENCIES.

(a) [As amended by Sec. 2 (a) of the Act of December 17, 1943, c. 346, 57 Stat. 601] *General Rule.*—Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax, at the rate of 6 per centum per annum from the date prescribed for the payment of the tax (or, if the tax is paid in installments, from the date prescribed for the payment of the first installment) to the date the deficiency is assessed, * * *.

* * * * *

(26 U.S.C. 1946 ed., Sec. 292.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * * *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall

be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612 (d) (2).

(26 U.S.C. 1946 ed., Sec. 293.)

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